Investment Arbitration and the Energy Charter Treaty

Treaty-based investment arbitration is becoming increasingly important in international commerce, and the Energy Charter Treaty (ECT) occupies a singular position in this regard as the only broad multilateral investment treaty in operation. In recognition of the Treaty’s distinctive profile, the Energy Charter Secretariat together with the Arbitration Institute of the Stockholm Chamber of Commerce organised in June 2005 a Conference on 'Investment Arbitration and the Energy Charter Treaty'.

The Conference was opened in Stockholm by H.M. the King of Sweden, with welcome addresses also from the Energy Charter’s Secretary General Ria Kemper and from the Secretary General of the Stockholm Institute, Ulf Franke. Participants and speakers at the Conference included leading experts on international arbitration.

“Given the importance of the energy sector and the protection offered by the ECT to investors in this sector, it is reasonable to assume that the number of arbitrations under the ECT will grow in the years to come.”

Kaj Hobér, Professor of East European Commercial Law at Uppsala University, writing in the Stockholm International Arbitration Newsletter 1/2005

Since the Treaty entered into force in 1998, there have been six cases registered by international investors pursuant to the Energy Charter Treaty. The first arbitration award under the Treaty was made in December 2003. Referring also to the experience with bilateral investment treaties, the Conference examined such issues as the concept of expropriation, investments and investors covered by the Treaty, the issue of state responsibility, and the relationship between contractual claims and claims under the ECT.

At the same time, as Secretary General Kemper underlined, the efficiency of the ECT should not be judged by the number of cases brought to arbitration or by the outcome of any particular case. “Effective dispute settlement mechanisms have significance beyond the cases that come before a tribunal, in that they provide persuasive encouragement for Contracting Parties to observe their Treaty obligations in the first place.”

It is anticipated that the proceedings of this Conference will be published before the end of 2005. More information will be made available on the web sites of the Energy Charter (www.encharter.org) and of the Stockholm Institute (www.sccinstitute.com).
Regional Energy Cooperation in Northeast Asia

Despite the fact that most Russia hydrocarbon reserves are in Asia, virtually all of the energy produced has moved westwards towards European markets. However, this situation is set to change in the coming years with the development of the oil and gas resources of Eastern Siberia, which will open up new possibilities both for the social and economic development of this region of Russia and also for export to the rapidly growing markets of Northeast Asia.

The Northeast Asian Gas and Pipeline Forum has been leading the efforts to promote the regional infrastructure that can support this new cross-border trade in natural gas. The forum brings together representatives of five countries – Japan, Russia, Mongolia, China and Korea – for collaborative research and debate on energy cooperation.

The Ninth International Conference on Northeast Asian Natural Gas and Pipeline took place in Seoul in September 2005, against a background of strong demand for energy across Northeast Asia and also the development of a Russian programme for a unified system of gas extraction, transportation and distribution in Eastern Siberia. The Conference looked in particular at how the prospect of piped gas to the region would interact with existing and future supplies of LNG.

Speaking at the opening session of the Conference, the Director General for the Energy Industry in the Korean Ministry of Commerce, Industry and Energy (MOCIE), Dr Jung-Sik Koh, delivered a strong message on the importance of regional energy cooperation among the countries of Northeast Asia. This was also a central theme in the keynote address from Dr Kemper, who outlined the benefits for Northeast Asia of a multilateral framework to encourage investment and to protect cross-border energy flows. The Secretary General underlined that the major partners in Northeast Asia are already associated with a relevant multilateral framework through the Energy Charter process. These partners include three signatories of the Energy Charter Treaty – Russia, Japan, and Mongolia – and two countries with the status of observer – China and Korea.

Dr Kemper urged the countries of the region to make full use of the Energy Charter framework as an optimal and ready-made platform for closer regional ties. The invitation for all countries to accede to the Treaty was endorsed and supported by the President of the Northeast Asian Gas and Pipeline Forum, Mr Hyun-Bum Sunwoo.

The full text of Dr Kemper’s presentation in Seoul is available on the Energy Charter’s web site www.encharter.org.

Workshops on the Charter process in Islamabad and Delhi

Discussions about new regional pipelines have stimulated interest in South Asia in the Energy Charter Treaty as a way of facilitating cross-border energy flows and protecting energy investments. The governments of both Pakistan and India invited the Secretariat to present the Energy Charter process in the spring of 2005. Workshops on the Charter were held in Islamabad and Delhi in March and April respectively.

The workshops were attended by representatives of relevant ministries as well as participants from the energy industry, and confirmed that the Charter Treaty is an instrument that can facilitate regional cooperation in this area. Following the workshops, the Director responsible for Trade, Transit and Relations with Non-Signatories, Ralf Dickel, held additional meetings with senior officials from both the Pakistani and Indian administrations, in order to discuss further the benefits and modalities of closer association by these countries with the Energy Charter process.
What Role for the ECT in EU-Russia Relations?

The Energy Charter process was originally conceived in the early 1990s as a framework for East-West dialogue, and Russia has been – from the start – a key country for the process because of its importance on global energy markets. The Charter process is no longer an 'East-West' process given its increasingly prominent Asian dimension (see facing page and news in brief), but the relationship between the enlarged EU and the Russian Federation remains pivotal to the process as a whole.

Russia is an active participant in the Charter and applies the Treaty provisionally, but has yet to complete ratification of the Treaty. Speaking in September to a Russian Gas Industry Round Table organised by the news agency Interfax, Secretary General Ria Kemper argued that the importance of the ECT to the EU-Russia relationship rests on two considerations. The first is the political intention to create an open and integrated market in the form of a 'Common Economic Space'. "In my view" noted Dr Kemper, "it is axiomatic that any common space must be based on common rules, such as those contained in the Energy Charter Treaty".

A second consideration is the shared desire to enhance energy security, a priority that Russia will be putting at the top of its political agenda as chair of the G8 in 2006. A key issue for the energy security of both Russia and the EU will be to minimise the risks associated with highly capital-intensive investment in new energy supply and in transportation capacity. The Energy Charter’s unique multilateral legal framework can assist in this regard by protecting and facilitating investment and cross-border energy flows.

The Secretary General reminded the Round Table that all the members of the G8, including the USA and Canada, are signatories to the Energy Charter Political Declaration, the 1991 document that provides the political foundation for the Charter process. "One could expect … that the Russian government should wish during its presidency of the G8 to demonstrate its commitment to a rule-based multilateral system for energy cooperation. The best possible demonstration of this commitment would be for Russia to push for adoption of the Energy Charter Protocol on Transit and to ratify the Energy Charter Treaty".

The full text of Dr Kemper’s speech in Tuapse is available on the Energy Charter’s web site, www.encharter.org

Update on the draft Transit Protocol

Representatives of the European Union and the Russian Federation have held a series of consultations in 2005 with the aim to prepare draft solutions at expert level for the outstanding issues in the text of the draft Energy Charter Transit Protocol.

The aim of the draft Protocol is to clarify specific operational issues related to energy transit, building on the principle of freedom of transit in the Energy Charter Treaty. Multilateral negotiations on the draft Protocol were provisionally completed already in 2002, but a limited number of open issues between the EU and Russia have held up final agreement on a text. In December 2004, the Energy Charter Conference expressed its full support for the finalisation of negotiations and adoption of the Protocol, and stressed the need to conclude this instrument “in a timely manner”.

The Russian and EU experts intend to present in October a joint report on the outcome of their discussions, detailing the significant progress that has been made and the areas where further work may be needed. This should allow for an assessment at political level on the best way to move towards finalisation of the Protocol.
Energy Investment: A Focus on Uzbekistan

Despite significant hydrocarbon reserves, Uzbekistan has yet to make its mark on the international energy scene. Foreign investment has been limited, and Uzbekistan has no direct access to international markets for its energy products. However, as the Charter's new in-depth review of Uzbekistan's investment climate and market structure makes clear, there are signs that efforts to improve the investment climate are underway.

Proven gas reserves in Uzbekistan amount to about 1.85 trillion cubic metres, exceeding the confirmed oil reserves of around 600 million barrels by a factor of twenty on an energy equivalent basis. The Uzbek energy sector is in need of investment: years of low cost recovery and reinvestment have left the domestic energy infrastructure in urgent need of rehabilitation.

The Secretariat’s findings, which are based on the in-depth review, highlight several reasons why foreign investment in the energy sector has been below potential. Investment for export purposes in the oil sector is not considered an attractive option because of the limited reserves and the absence of an adequate export pipeline. There are existing gas pipelines leading out of Uzbekistan, notably through Kazakhstan towards Russia. However, these main export pipelines are operated by Gazprom, and this may discourage other parties from investing in upstream gas because of uncertainty over access to the Gazprom network.

Considering the domestic investment climate, a disincentive to foreign investment has been the dominant role of the state in the energy sector, and the fact that regulated prices of energy products to Uzbek consumers have in the past been well below market levels. There has also been a hesitant approach towards privatisation.

The report commends some recent policy changes and measures taken by Uzbekistan to improve the climate for investments, but argues that these need to be continued and expanded if the country is to realise its potential. In particular, it recommends further efforts to improve the consistency and transparency of legislation, and also to define and limit the role of the state in the energy sector.

The recommendations arising from the review will be considered by the meeting of the Energy Charter Conference at its meeting in December 2005. In the meantime, the report itself is available on the Energy Charter’s web site, www.encharter.org.
Belarus and the Energy Charter Treaty

“As a country without significant resources of hydrocarbons of its own, but as an important transit country, Belarus is interested to participate in the activities of the Energy Charter”. These were the words of the Belarusian deputy Prime Minister, Vladimir Semashko, at the opening of a workshop in Minsk in June on the Energy Charter Treaty and its relevance for Belarus. The objective of the workshop was to examine the benefits that could accrue from full participation by Belarus in the Charter process. Belarus is one of five signatory states to the Energy Charter Treaty that have yet to complete the process of ratification.

Discussions at the workshop did not show up objections to the substantial provisions of the Treaty. At the same time, as Deputy Speaker Sergei Zabolotets from the Belarusian Chamber of Representatives pointed out, Belarus is also taking into account the position taken by Russia on this issue, given the political intention to create a union state and to coordinate legislation between the two countries in the energy sector.

Iceland: a Renewable Approach to Energy Policy

Iceland stands out among Energy Charter member states for its extensive use of renewable energy sources. Its electricity and heating comes from hydroelectric power and the geothermal water reserves, providing energy that is accessible, renewable, relatively inexpensive and from which pollution is minimal. About 90% of all houses in Iceland are heated by energy from geothermal resources, and electricity generation comes either from hydropower (83%) or geothermal energy (17%). Fossil fuels are used only where it is not technologically feasible to use renewable resources, that is, in transport and in the fisheries sector.

The policy of the Icelandic government is to harness clean energy reserves for sustainable development and to improve living standards. Most of the renewable energy sources are still unharvested. Iceland has also been a pioneer in the production and use of alternative fuels, particularly with regard to hydrogen: a project for hydrogen-powered buses is already operational in Reykjavik.

The Energy Charter’s review of energy efficiency in Iceland provides a valuable overview of the country’s unique energy endowments and policies, and is available to download from the Charter’s web site, www.encharter.org.

Examining Moldova’s Energy Security

Moldova is almost entirely dependent on imported energy, and the debate over security of energy supply is central to Moldovan energy policy. The Secretary General had the opportunity to participate in this debate when invited to give a keynote address to the “Moldova Energy – 2005” Conference, which took place in Chisinau in September.

In the last two years the Energy Charter has completed a report on Moldova’s investment climate and market structure (2003) and also an in-depth review of its programmes and policies on energy efficiency (2004). In her presentation to the Conference, the Secretary General highlighted the way in which the Energy Charter framework can assist in meeting key challenges for the Moldovan energy sector, including the priority to promote investment in infrastructure and to ensure diversified and reliable energy supply. Referring to the energy efficiency review, she argued that efforts to promote energy efficiency and local and renewable sources of energy can play a significant role in enhancing Moldova’s overall energy security.

While in Chisinau, Dr Kemper met with the Minister of Industry and Infrastructure Vladimir Antosii, Minister of Foreign Affairs Andrei Stratan, the President of the Moldovan Academy of Sciences Gheorghe Duca, and the Deputy Speaker of Parliament Iurie Rosca.
Models for Energy Cooperation in Southeast Asia

The Association of Southeast Asian Nations (ASEAN) was the most recent entity to take on observer status at the Energy Charter Conference. Its application was approved by the Conference in December 2003, and ASEAN is represented in its dealings with the Charter by the ASEAN Centre for Energy in Jakarta.

Following on from her visit to Seoul (see page 2), the Secretary General visited Jakarta in October in order to continue the dialogue with ASEAN and to examine the prospects for closer association by the countries of ASEAN with the Energy Charter process. She held meetings with the Executive Director of the ASEAN Centre for Energy, Mr Weerawat Chantanakome, and also with senior officials in the ASEAN Secretariat responsible for energy and infrastructure issues, Dr Worapot Manupipatpong and Mr Honorio R. Vitasa.

The ten countries of ASEAN are looking to improve the cross-border interconnections for gas and electricity and to foster a regional approach to energy security through the development of a Trans-ASEAN gas pipeline and an ASEAN power grid. ASEAN Ministers recognised in their Action Plan for energy cooperation, adopted in June 2004, that the experience of the Energy Charter can be very useful in facilitating the implementation of these projects.

Dialogue between the Charter process and the ASEAN oil and gas industry was also a theme at the Asian Pipeline Conference in Kuala Lumpur in September, where the Secretariat’s Director for Trade, Transit and Relations with Non-Signatories, Mr Ralf Dickel, was invited to make a presentation on the Charter’s role in securing cross-border energy flows.

New Reports available on Croatia, Hungary and Armenia

The Energy Charter has released a follow-up review of the investment climate and market structure of Croatia. This report examines in detail Croatia’s progress in implementing the Charter’s policy recommendations made in July 2002 on the basis of an initial investment review.

In addition, both Hungary and Armenia presented reports in spring 2005 to the Working Group on Energy Efficiency regarding their national policies and programmes in this area. Copies of all country reviews and reports are available on the Charter’s web site (www.encharter.org).

Deputy Secretary General addressing Eurasian Energy Security

“Stability, proper public and corporate governance, and transparency are nowadays key components of energy security – and the creation of common rules of the game and adequate investor protection is an indispensable element.” This was the message delivered by Dr Andrei Konoplyanik, Deputy Secretary General, to a Worldwide Security Conference organised by the East-West Institute in Brussels. Dr Konoplyanik’s speech to this Conference, along with other recent presentations, is available on the Charter’s web site (see section ‘Secretariat’ and link to ‘Deputy Secretary General’).

New arrivals at the Secretariat

The Secretariat has welcomed two new energy experts, from Russia and from Georgia, as new members of staff in the autumn of 2005.

Julia Selivanova has specialised in international economic law and the energy sector, and joins the Secretariat from the private sector.

Thea Khitarishvili is a lawyer and regulatory specialist with broad experience in working on energy projects and transactions for a range of clients, including governments, multilateral agencies and private energy companies.
Forthcoming Events

Conference:

Risk Reduction in the Energy Sector

Brussels, 26 October 2005

A gradual erosion of available surplus capacity in crude oil production has accompanied the increase of oil prices during the last several years. It is a situation that has not been experienced before: The world has run out of surplus capacity in the single most important type of energy. In addition, refinery runs have also been close to available capacity in most parts of the world. To mitigate the impact of this, massive investment will be needed in the petroleum industry.

Similar trends are seen in other energy sub-sectors, some of them on a global scale and some on a regional scale. The IEA has estimated that global investment in the power sector will have to increase three-fold over the next three decades in comparison with the last three decades. Both OECD and non-OECD countries will be affected, albeit in different ways. In the OECD area, there will be a need to upgrade and replace aging energy infrastructure, especially refining. In other countries, the problem would be to build most of the infrastructure, especially upstream and midstream.

In the gas sector there are growing investment needs for the development of new production capacities globally and not least in the ECT region. To bring the gas to the market will require growing investments in upstream and transportation capacity. Already today, there exist many bottlenecks in the pipeline transportation and needs for modernisation and upgrading.

It will be impossible to meet future demand for energy without major and continuous investment in all major energy sub-sectors, and in particular oil and gas. At the same time, the petroleum business is confronted with new and growing risks in various areas.

This is the fourth in a series of autumn conferences organised by the Secretariat on major policy issues, and it is organised on this occasion in cooperation with the IEA. The purpose of this Conference is to discuss the new risk environment for foreign investors in the energy sector and to look at ways to mitigate risk and to identify an appropriate balance between the interests of investors and host countries. The Conference will focus in particular on the conditions for investing in oil and gas production, as well as downstream issues including access to pipelines.

As well as speeches from senior representatives of both the IEA and Energy Charter Secretariat, this one-day Conference will feature presentations from senior representatives of producing countries, pipeline owners, foreign investors and private financiers. More information is available at www.encharter.org.
THE MISSION AND OBJECTIVES OF THE ENERGY CHARTER

The mission of the Energy Charter process is:

- to strive towards open, efficient, sustainable and secure energy markets
- to promote a constructive climate conducive to energy interdependence on the basis of trust between nations

In the broadest terms, this mission will be achieved through:

- strengthening and extending the rule of law to facilitate market developments in the energy sector
- establishment of rules of conduct, guidelines, standards and recommendations for open efficient and sustainable energy markets
- developing clear, commonly-accepted rules on energy transit
- helping countries to develop national energy efficiency policies
- peer-group reviews of countries’ progress towards their Energy Charter obligations
- expanding the geographical coverage of the Energy Charter process
- developing the Energy Charter Conference’s role as a key intergovernmental forum for East-West policy discussions.

The term “Energy Charter process” is used to cover all obligations contained in, and activities relating to, the 1991 European Energy Charter; the 1994 Energy Charter Treaty (as amended by the 1998 Trade Amendment); and the 1994 Energy Charter Protocol on Energy Efficiency and Related Environmental Aspects.

For more information, or to receive this newsletter on a regular basis, please contact us at:

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